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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

No. 410

TRICO PRODUCTS CORPORATION,
Petitioner

v.

GEORGE T. McGOWAN, Collector of Internal Revenue for the Twenty-eighth District of New York,
Respondent.

PETITION FOR REHEARING

BRUCE BROMLEY,
Attorney for Petitioner.

CASES CITED

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To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner respectfully prays that this Court reconsider its decision of December 20, 1948, denying petitioner's application for a writ of certiorari.

I.

The petition for a writ of certiorari presented two clear-cut questions of law of the greatest importance in the administration of the revenue laws, as follows:

1. In determining the applicability of Section 102 of the Revenue Act of 1936, can evidence as to non-

surtax saving purposes properly be excluded from consideration on the ground that the carrying out of those purposes satisfied no business need of the corporation?

2. Does Section 102 prevent the conservation of current earnings to meet known and provable future contingencies and exigencies, pursuant to a program of internal corporate financing established long before the tax year involved, simply because the ultimate expenditure of the funds cannot be precisely blue-printed or definitely budgeted in the tax year in question?

Respondent's answering brief succeeded in obscuring the questions of law thus presented and in leaving the impression that only a question of fact was involved. The misimpression created by respondent's brief was, we believed, corrected by petitioner's reply brief.

Due, however, to an unfortunate delay by the Post Office, petitioner's reply brief did not reach Washington until Friday, December 17, and petitioner therefore has been left in a state of uncertainty as to whether the reply brief arrived in time for study prior to the reaching of the decision that was announced the following Monday. If not, we respectfully urge the Court to reconsider the petition on the basis of the reply brief, which in a matter of five pages succinctly analyzes the errors of law embodied in the lower courts' interpretation of the statute and corrects the misimpression created by respondent's brief.

II.

A substantial ground for granting certiorari, not previously presented by petitioner, is the conflict of the decision of the Court of Appeals in the present case with the rule, applied in other Circuits, that the presumption arising from the accumulation of earnings beyond corporate business needs may be overcome by evidence of non-surtax saving purposes regardless of whether those purposes had any relation to the corporate business needs.

As pointed out in the petition, the evidence clearly established, and it was acknowledged by the lower courts, that petitioner's controlling stockholders were motivated by a purpose to carry out the provisions and underlying intent of agreements entered into in 1927 in connection with the sale by those stockholders of a part of their holdings. Those agreements made it incumbent upon petitioner's directors to conserve a part of petitioner's earnings not only for the protection of the other parties to the agreements but also in order to bring about the release of petitioner's deferred stock in the legitimate self-interest of the controlling stockholders. Nevertheless, the lower courts refused to give effect to that purpose on the ground that the carrying out of the 1927 agreements "satisfied no business need of the Corporation."

Under the ruling of the lower courts, the presumption based on accumulations beyond business needs is made conclusive of liability, since all other proof of whatever nature would be discarded on the simple ground that it had nothing to do with the needs of the business. That ruling flies in the face of the statute and is in conflict with the accepted rule in the other Circuits, where it is recog-

nized that the presumption is rebuttable by proof of non-surtax saving purposes, regardless of whether those purposes had anything to do with the needs of the business. The rule was stated in *United States* v. *R. C. Tway Coal Sales Co.,* 75 F. 2d 336, 337 (C. C. A. 6th, 1935) as follows:

> "The Commissioner in 1927 certified that in his opinion the accumulations of earnings for 1922 and 1923 were unreasonable for the purposes of the plaintiff's business, and exacted for each of those years the additional tax authorized by section 220 (now 102). Without such certification there is of course no presumption. With it it may arise, but is none the less rebuttable by proof, for the presumption does no more than make the taxpayer 'show his hand.' "

The foregoing rule actually had its origin in the Second Circuit, in *United Business Corporation of America* v. *Commissioner,* 62 F. 2d 754 (1933). In that case the Court stated that "the test remains the state of mind itself, and the presumption does no more than make the taxpayer show his hand." The Court held that there could be no constitutional objection to the vagueness of the "needs of the business" test "since the result of the presumption is at most no more than to compel the taxpayer to disclose the facts."

The Court of Appeals for the Second Circuit, in now abandoning the rule first established by it, and in holding that a taxpayer is confined to evidence regarding business needs, thus making the presumption virtually conclusive, has placed itself in conflict with the Courts in the other Circuits who have adopted and adhered to the rule first announced in the Second Circuit.

In the *Tway* case, where the Trial Court had found that earnings were not accumulated beyond reasonable business needs of the Corporation, the Government complained that the Trial Court regarded that finding as conclusive, thereby denying the Government the right to prove by other evidence that the accumulations were nevertheless made for the prohibited purpose. The Appellate Court correctly pointed out that the ultimate question under Section 102 is purpose, regardless of business needs. In the present case, where the finding as to business needs was the other way, the Government is content to regard the resulting presumption as conclusive and to abide by a decision which denies the taxpayer the right to "show his hand" or "disclose the facts" because those facts "had nothing to do with the needs of the business."

Under the decisions of the lower courts there could be no proper purpose that could be served through the accumulation of earnings or profits other than satisfying the business needs of the corporation. The statute, however, neither reads nor was intended to operate that way. The fundamental question under Section 102 is purpose, and the statute does not characterize as a surtax saving purpose that which is not a surtax saving purpose merely because it is not a corporate business purpose.

However unwise, it would undoubtedly have been within the power of Congress to enact a statute, if it chose to do so, which (1) would compel the distribution of all earnings not needed in the business, regardless of actual purpose or motive, and (2) would authorize the measuring of

business needs by a yardstick that would exclude consideration of proper future corporate needs and exigencies if the amount required to finance those needs cannot be precisely budgeted and determined at the time the corporate funds are conserved. We are now dealing, however, with a specific enactment of Congress which embodies neither language nor intent to that effect.

In the interest of seeing to it that the law is administered as written, it is submitted that this Court should grant a review of the vital issues now at stake. We can say beyond any question that Section 102 today is causing greater concern in the business world than any other provision in the tax laws, directly as a result of the decisions involving petitioner. In the Federal Tax Report Bulletin of Prentice-Hall, Inc. (Vol. XXIX No. 50, December 16, 1948), received on the day on which certiorari was denied, the lead article is devoted to the Trico case and to a warning to directors that they act in peril of personal liability in determining corporate financial policy. The results of the lower courts' decisions stand out for all to see. The Taxation Report of the Research Institute of America (Vol. 5, No. 26, December 22, 1948) contains the following notation:

> "*Trico Products Corp.* v. *McGowan,* 169 F. (2d) 343. The conservation of earnings to release restricted stock was not a business need of the corporation but rather a help to the stockholders. Sec. 102 penalty was imposed. (Cert. den. 12/20/48)"

Petitioner naturally is concerned with remedying a serious injustice to it. Equally important, however, is the urgent need, in the public interest, for this Court to inter-

pret the statute and lay at rest the doubts and confusion engendered by lower court rulings such as petitioner seeks to have this Court review.

Petitioner prays that the Court grant this petition for a rehearing and upon such rehearing grant the petition for a writ of certiorari.

Respectfully submitted,

BRUCE BROMLEY,
Attorney for Petitioner.

FRED W. MORRISON,
WILLIAM GILBERT,
RICHARD T. DAVIS,
of Counsel.

Certificate of Counsel

I hereby certify that this petition is presented in good faith and not for delay, and is restricted to the grounds specified in Rule XXXIII of the Rules of this Court.

BRUCE BROMLEY,
Attorney for Petitioner.